


**MEMORANDUM
OFFICE OF THE COUNTY ATTORNEY
LOUDOUN COUNTY, VIRGINIA**

DATE: June 26, 2007
TO: Board of Supervisors
FROM: John R. Roberts, County Attorney 
SUBJECT: Tax Increment Financing for Water Lines in Potomac Farm

At the request of Supervisor Waters, the Board directed staff to explore tax increment financing to fund the extension of LCSA water lines to serve lots in the Potomac Farm subdivision. It is my understanding the LCSA staff may have promoted this concept based on the County's experience in funding sewer lines in the Broad Run Farm subdivision.

This memorandum will review the law governing tax increment financing generally, address the question of including property in a tax increment financing district that does not benefit from the improvement project, and compare the proposed Potomac Farm project to the Broad Run Farm project.

Tax Increment Financing

Tax increment financing is a method of allocating tax generated by the growth in assessments within a designated area to an improvement project for the area. Tax increment financing does not generate new revenue, but rather sets aside a portion of the general levy in an area for a specific improvement. The base assessment is the year when the tax increment financing district is established, and the County tracks any growth in assessments in future years. The difference between the base year and a future assessment is the increment. Applying the applicable tax rate to that increment, the County segregates that portion of the general levy for the project.

A typical concept underlying tax increment financing is the need to provide public improvements to help rehabilitate a blighted area. If a blighted area is rehabilitated, assessments will rise. Those increases are used first to pay for the improvements. Once the project is paid off, the improved assessment base will generally benefit the locality. A similar analysis may support a tax increment financing project to spur new development that has a positive fiscal impact on the locality.

In Virginia, tax increment financing by localities is authorized under Va. Code § 58.1-3245 *et seq.* The statute includes the following statement of purpose:

It is hereby found and declared that blighted areas exist in the Commonwealth, and these areas impair and endanger the health, safety, morals and welfare of the citizens because commercial, residential and industrial structures or improvements are subject to dilapidation, deterioration, inadequate ventilation, and inadequate public utilities. It is a public purpose to provide public facilities including, but not limited to, roads, water, sewers, parks and real estate devoted to open-space use as that term is defined in § 58.1-3230 within redevelopment and conservation areas to encourage the private development in such areas in order to eliminate blighted conditions. It is essential to the public interest that governing bodies have authority to finance development project costs by using real estate tax increments to encourage private investment in development project areas.

Va. Code § 58.1-3245.1.¹

The Board adopts tax increment financing by designating a "development project area." That term is defined only as "any area designated for development or redevelopment in an ordinance passed by the local governing body." Va. Code § 58.1-3245. "Development project cost" is broadly defined and follows the same definitions for capital project costs as used under the Public Finance Act.

Inclusion of Property Not Intended to be Benefited by the Improvement Project

It has been suggested that vacant commercial land adjacent to the Potomac Farm subdivision be included in the designated development project area in order to boost the tax

¹ Prior to amendments in 2006, the second sentence of this section included what appeared to be a broader statement of purpose, as follows:

It is also found to be in the public interest to promote the commerce and prosperity of the citizens of the Commonwealth by providing public facilities, including but not limited to, roads, water, sewers, parks and real estate devoted to open-space use as that term is defined in § 58.1-3230 in development project areas to encourage the development of such areas.

With the 2006 amendment, the purpose section now appears to be focused on blighted areas and redevelopment, and not generally on promoting commerce and prosperity through the provision of public facilities.

The Code of Virginia also includes provisions for tax increment financing in a "local enterprise zone." Va. Code § 58.2-3245.6. This statute would have no application to the proposed Potomac Farm subdivision project. The county may only designate a local enterprise zone where the Governor has declared an enterprise zone under the provisions of Va. Code § 59.1-538 *et seq.*

increment available for improvements. No improvements financed by the tax increment will be located on those adjacent properties, and none of the financed improvements will serve those adjacent properties. If the intention is to commit additional general tax funds to the project to make up a shortfall in the tax increment generated by the benefited properties, there is no need to include these adjacent properties. The Board would simply commit to a one-time supplemental appropriation, or a yearly payment subject to annual appropriations, to make up the shortfall. The Board has done this with the Aldie and Hamilton sewer projects, although both used a special additional tax, not tax increment financing, to raise funds within the respective district. In Aldie, the Board made a one-time supplemental appropriation of general revenue, and in Hamilton, the Board makes a supplemental, annual appropriation out of general revenue.

One concern about including non-benefited property is whether owners of that land will make some claim for financing improvements on their sites. Regardless of how it is drawn, the tax increment district does not generate any new money. Accordingly, I would draw it only to include the benefited properties and cleanly avoid such collateral issues.

Comparison with the Broad Run Farm Project

LCSA staff has noted the County's positive experience with the Broad Run Farm sewer project, which included tax increment financing. This truly was a success story. Broad Run Farm was an older subdivision with relatively small lots served by onsite septic systems. By the early 1990's a number of those systems were beginning to fail, without reserve fields available for use. The County considered this a serious health and safety issue, having a significant impact on the property values in the subdivision.

After substantial work with the community, the County and LCSA financed and constructed sewer lines serving the subdivision. LCSA received a loan from the Virginia Resources Authority. The County established a district that imposed an additional tax on real estate and also designated the area for tax increment financing. The combination of the additional tax and the tax increment were used to cover the LCSA debt service on the loan. The County and LCSA entered a service agreement under which LCSA took down the loan and built the improvements and the County agreed to make the annual payments from the collection of the surtax and tax increment.

Along with the general increase in real estate values, the district experienced new development on vacant lots and expansion or rehabilitation of existing properties. As a result, the tax increment was able to fund the early retirement of the loan. This was possible in part because the County maintained the initial rate for the surtax throughout the life of the district. The surtax has been discontinued and the full amount of the general tax levy now goes to the general fund.

There are some significant considerations in comparing the Broad Run Farm and Potomac Farm projects. First, the Potomac Farm project involves replacement of an older, substandard water system. The effect of this improvement on the tax increment may not be dramatic as in the Broad Run Farm situation, which involved the installation of a sanitary sewer

system in an area not served by utilities. There, the installation of the sewer made it possible to develop a number of vacant lots, with a significant impact on the tax increment. Second, the Broad Run Farm project was made possible through a Virginia Resources Authority loan. A source of financing for the Potomac Farm project has not been identified, although it may be possible for LCSA to fund the project subject to repayment from the tax increment or other sources. Finally, the Broad Run Farm project included a significant additional special tax which contributed to retirement of the loan.

Please do not hesitate to contact me if you have any questions.

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